

Clean Energy

E-ALERT

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FERC ADOPTS SMART GRID AND INTERIM RATE POLICY AND REAFFIRMS NEED FOR DEMAND RESPONSE

At its July 16, 2009 meeting, the Federal Energy Regulatory Commission adopted a Policy Statement regarding standards for the Smart Grid and an Interim Rate Policy, and issued a rehearing order reaffirming the need for demand response in organized electric markets.

I. SMART GRID POLICY STATEMENT

FERC issued a proposed policy statement on March 19, 2009 and requested comment on the proposed policy. FERC received more than 70 sets of comments from interested groups, which indicated support for the proposed policy. The final Smart Grid Policy Statement closely tracks the proposed policy issued March 19, 2009.

FERC explained that Smart Grid advancements will apply digital technologies to the grid and enable two way communications and real-time coordination among generating plants and demand-side resources. The Smart Grid will improve efficiency of the bulk power system and control energy costs for consumers. For this to work, communications among smart grid devices and systems must achieve interoperability.

In the Policy Statement, interoperability is defined as “exchanging meaningful information between two or more systems and achieving an agreed expectation for the response to the information exchange while maintaining reliability, accuracy, and security.” The Smart Grid Policy Statement sets forth priorities for developing key standards for the interoperability of Smart Grid Systems.

The Energy Independence and Security Act of 2007 (EISA) directed the National Institute of Standards and Technology (the Institute) to coordinate the development of a framework that includes protocols and model standards for information management to achieve interoperability of smart grid devices and systems. EISA directed FERC to institute a rulemaking proceeding to adopt such standards and protocols needed to insure smart-grid functionality and interoperability in interstate transmission of electric power, and regional and wholesale electricity markets, once FERC is satisfied that the Institute’s work has led to “sufficient consensus.”

FERC has adopted priorities in order to achieve the EISA’s goals and characteristics of a smart grid. These goals and characteristics, as set forth in EISA Section 1301, include deployment or realization of:

- Digital information and technology to improve reliability, security, and efficiency
- Cybersecurity

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- Distributed resources and generation
- Demand response
- “Smart” technologies for optimal grid operations and distribution automation
- “Smart” appliances
- Electricity storage
- Consumer information and control
- Communication and interoperability standards

FERC will not interfere with states' abilities to adopt advanced metering or demand response programs. FERC did note, however, that although EISA does not alter the FPA's jurisdictional boundaries between federal and state regulation over the rates, its mandate to insure “functionality and interoperability in interstate transmission of electric power and regional and wholesale electricity markets” does mean that the FERC has the authority to adopt standards that will be applicable to all electric power facilities and devices with smart grid features, including those at the local distribution level and those used directly by retail customers so long as the standard is necessary to insure functionality and interoperability.

Chairman Wellinghoff stated that the Smart Grid Policy Statement “will help to inform and accelerate the smart grid standards development process so that proposed standards will be submitted for Commission Review and approved in an expeditious manner.” He further expressed enthusiasm that “the increased efficiency, reliability and flexibility of a ‘smart’ electric system will result in long-term savings for consumers.”

Commissioner Kelly explained that the Policy Statement “provides a roadmap to transforming the old grid into the grid of the future” in response to the “urgent need to modernize the grid by developing and implementing a range of new technologies.”

Commissioner Spitzer praised the Policy Statement for striking a balance by encouraging utilities and developers to develop and install smart grid technologies before standards are finalized while at the same time protecting consumers from wasteful investment. He also highlighted the need for the application of smart rates in addition to development of smart grid standards.

The Smart Grid Policy Statement will take effect 60 days after publication in the Federal Register.

A. FERC PRIORITIES

In adopting priorities to guide the Institute's development of standards. FERC seeks to develop Smart Grid functions and characteristics that can help address challenges facing the FERC-jurisdictional bulk power system and promote its broad policy goals. FERC places priority on developing interoperability standards in two broad categories important to the bulk power system.

The first broad priority category is described by FERC as the two cross-cutting issues of cybersecurity and communication. In this category, FERC adopts as Commission priority early industry development of standards to:

- ensure the cybersecurity of the grid
- provide two-way communications among regional market operators, utilities, service providers, and consumers

The second broad priority category is key grid functionalities. In this category, FERC adopts as commission priority early industry development of standards for:

- wide-area system awareness (the visual display of interconnection-wide system conditions in near real time at the reliability coordinator level and above) to give reliability entities an improved and manageable high-level view of system conditions and parameters
- demand response to reduce wholesale prices and wholesale price volatility and reduce potential generator market power
- electricity storage to provide services to the bulk-power system
- electric transportation to maintain the reliable operation of the bulk power system

B. INTERIM RATE POLICY

The Commission adopted an Interim Rate Policy to allow recovery of jurisdictional smart grid costs if certain showings are made by adopters of smart grid technologies. The Interim Rate Policy provides for assurance of recovery of future smart grid costs. The Interim Rate Policy will be effective until relevant interoperability standards have been adopted through Commission rulemakings.

In order to recover FERC-jurisdictional smart grid costs, a public utility must file a petition for a declaratory order or an FPA Section 205 filing demonstrating the following:

- the smart grid facilities will advance the goals of EISA section 1301
- the reliability and cybersecurity of the bulk-power system will not be adversely affected by the deployment of the smart grid facilities at issue
- the applicant has minimized the possibility of stranded investment in smart grid equipment in light of the fact that such filings will predate adoption of interoperability standards
- the applicant must agree to share information with the Department of Energy Smart Grid Clearinghouse to help with the interoperability standards development process

Under the Interim Rate Policy, FERC will allow single issue rate treatment for smart grid facilities, recovery of stranded costs of legacy systems replaced by smart grid facilities, and incentive rate treatments for accelerated depreciation and abandonment authority. The Interim Rate Policy is effective 60 days after publication in the Federal Register.

II. DEMAND RESPONSE

On July 16, 2009, FERC issued an order on rehearing to affirm its determinations in Order No. 719, Wholesale Competition in Regions with Organized Electric Markets, 73 FR 61,400 (Oct. 28, 2008), FERC Stats. & Regs. ¶ 31,281 (2008). In Order No. 719, FERC amended Commission regulations to improve the operation of organized wholesale electric markets in demand response, long-term power contracting, market monitoring policies, and the responsiveness of RTOs and ISOs to stakeholders.

In particular, the rehearing order reaffirmed that FERC shall remove barriers to demand response because demand response directly affects rates in organized wholesale electric markets. FERC reaffirmed the following policies regarding demand response resources in organized wholesale markets:

- Each RTO or ISO must accept bids from demand response resources, on a basis comparable to any other resources, for ancillary services that are acquired in a

competitive bidding process that meet certain standards, unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate. FERC clarified that such bids may come from energy efficiency resources.

- RTOs and ISOs rules must permit retail customer aggregators to bid demand response on behalf of retail customers directly into the RTO's or ISO's organized markets, unless the laws or regulations of the relevant electric retail regulatory authority do not permit a retail customer to participate. However, the rehearing order indicated flexibility by FERC to allow states and others to participate in the determination of retail customers' eligibility to provide demand response to wholesale markets. Specifically, a small utility's retail regulator must authorize aggregation before market operators are permitted to accept bids including aggregated demand response by customers of small utilities that distributed up to 4 million megawatt hours during the previous year. In addition, retail regulators may prohibit customers of larger utilities from participating in wholesale markets and preclude RTOs and ISOs from accepting bids of companies that aggregate demand response from these customers.
- RTO or ISO market rules that do not allow for prices to rise sufficiently during an operating reserve shortage to allow supply to meet demand are unjust, unreasonable, and unduly discriminatory. FERC identified four methods for allowing such pricing: (1) increase bid caps only during an emergency; (2) increase bid caps only for demand bids while keeping generation bid caps in place; (3) establish a demand curve for operating reserves, which has the effect of raising prices in a previously agreed-upon way as operating reserves grow short; and (4) set the market-clearing price during an emergency for all supply and demand response resources dispatched equal to the payment made to participants in an emergency demand response program.

Chairman Wellinghoff stated, "Incorporating demand response is essential to fulfilling the Commission's fundamental responsibility to ensure that energy markets produce just and reasonable rates."

The rehearing order takes effect 30 days after publication in the Federal Register.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our energy practice group:

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